Supreme Court, U.S.
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No. 09-682

IN THE

Supreme Court of the United States

LEONARD BOSACK, *ET AL.*,
Petitioners,

v.

DAVID C. SOWARD, *ET AL.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

The petition demonstrated that the $20 million in punitive damages awarded in this case—a 20-1 ratio of punitive damages to compensatory damages—was plainly unconstitutional, and that the Ninth Circuit's approach gives arbitrators unbridled power to impose unconstitutionally excessive punitive damages. Pet. 3, 12-13. Indeed, the petition observed that under the Ninth Circuit's decision, the arbitrators could have imposed a $40 million or even a $100 million award. Pet. 3. Respondents do not dispute these points. Notably absent from the opposition is any attempt to reconcile the arbitrators' award with the constitutional limits on punitive damages awards. Nor is there any attempt to explain how the Ninth Circuit could have avoided confirming a $100 million (or, for that matter, a $1 billion) punitive damages award. Instead, Respondents argue that the Ninth Circuit correctly held that due process imposes no restriction at all on the size of punitive damages awards in arbitration.

That holding conflicts with the decisions of other jurisdictions, which have held that such awards must be subject to meaningful review. Moreover, it raises a recurring issue of evident importance, especially in the vast confines of the Ninth Circuit where arbitrations must now be conducted without any meaningful review of punitive damages awards. This Court's review is warranted.

1. Respondents first argue that review is unwarranted because the question petitioners present was not presented to the court of appeals. Br. in Opp. 10. Respondents are incorrect.

The question presented by petitioners is "[w]hether an arbitral award of punitive damages is subject to constitutional constraints on excessiveness." Pet. i. Petitioners clearly presented that issue to the court of appeals. As the court of appeals recognized, petitioners "challenge[d] the constitutionality of the punitive damages award" on the ground that it far "exceed[ed the] 1:1 ratio" required by this Court's decisions. Pet. App. 14a.

In any event, petitioners are free to raise in this Court any issue "passed upon" by the court below, regardless of whether they previously raised it. *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 379 (1995); *see Citizens United v. Fed. Election Comm'n*, No. 08-205, 2010 WL 183856, at *9 (Jan. 21, 2010) (noting that petitioner "raise[d] this issue for the first time before us, but we consider the issue because 'it was addressed by the court below'") (quoting *Lebron*, 513 U.S. at 379). The courts below directly "passed upon" the question presented here. The district court held that, "[b]ecause due process does not apply to arbitration awards, the Court cannot vacate the awards based on their excessiveness." Pet. App. 69a (citing *Barnes v. Logan*, 122 F.3d 820, 824 (9th Cir. 1997); *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943, F.2d 1056, 1063-64 (9th Cir. 1991)). The court of appeals expressly "agree[d]" with the district court that due process does not apply to arbitral awards, and that it therefore "could not vacate the arbitration award for excessiveness." Pet. App. 14a. Consequently, the question whether an arbitral award of punitive damages is subject to constitutional constraints on excessiveness is properly presented here.

2. This Court's review of the question presented is warranted because the decision below squarely conflicts with decisions from other jurisdictions.

In *Birmingham News Co. v. Horn*, 901 So. 2d 27 (Ala. 2004), *overruled on other grounds, Hereford v. D.R. Horton, Inc.*, 13 So. 3d 375, 379 (Ala. 2009), the Alabama Supreme Court "readily perceive[d] the requisite state action underlying" the district court's confirmation of the arbitrator's award in that case, and concluded that the state action was "sufficient to justify [its] review of the award[] under governing federal due-process considerations." *Id.* at 66. Consistent with that holding, the Alabama Supreme Court undertook review of the arbitrator's award to ensure that it was not constitutionally excessive. *Id.* at 66-69.

Petitioners argue that there is no conflict between the decision below and *Birmingham News* because the Alabama Supreme Court engaged in constitutional review under the manifest disregard standard, while the court below also invoked the manifest disregard standard, albeit after holding that no constitutional review was required. Br. in Opp. 19-20.

Respondents' effort to blur the fundamental distinction between the two decisions is unavailing. The Constitution requires "meaningful and adequate [judicial] review" of an award of punitive damages. *Honda Motor Co. v. Oberg*, 512 U.S. 415, 420 (1994). That requirement can be satisfied through a number of different review standards, including "meaningful and adequate" manifest-disregard review. It cannot be satisfied, however, by manifest-disregard review

that is neither meaningful nor adequate. Because the Alabama Supreme Court held that the Constitution requires review of an arbitrator's punitive damages award for excessiveness, it proceeded to engage in manifest-disregard review that was both meaningful and adequate. 901 So. 2d at 66-69. In particular, it carefully examined whether the arbitrator's ratio of punitive damages to compensatory damages was consistent with this Court's precedents. *Id.* at 68-69 (indicating that a 26 to 1 ratio would be inappropriate, but the arbitrator's ratio of 2.5 to 1 was permissible).

In contrast, the court below examined only whether the arbitration panel identified and purported to apply the Court's excessiveness precedents. It did not examine, as the Alabama Supreme Court did, whether the award so far deviated from the ratio required by this Court's precedents as to constitute a manifest disregard of them. Pet. App. 14a.

This case dramatically illustrates the difference between the two approaches. In this commercial dispute involving solely economic injury and a compensatory damages award exceeding $1 million, this Court's decisions limit punitive damages to a 1-1 ratio. *See State Farm Mut. Auto Ins. Co. v. Campbell*, 512 U.S. 415, 425 (1994); *Exxon Shipping Co. v. Baker*, 128 S. Ct. 2605, 2626-28 (2008). The arbitration panel nonetheless awarded punitive damages at a ratio of 20-1. Based on its view that no constitutional review was required, the court of appeals upheld enforcement of the award because the arbitration panel identified and purported to apply the Court's precedents. But under the standard of meaningful and adequate review required by the

Constitution and applied by the Alabama Supreme Court, the award must be vacated because it manifestly disregards the ratio called for by this Court's decisions.

Nor does this case set the upper boundary on the amount of an award that an arbitration panel could impose. Under the standard adopted by the court of appeals, the arbitration panel could have imposed a $50 million, $100 million, or even a $500 million award, and the district court would have been required to enforce it. The standard applied by the Alabama Supreme Court, by contrast, would require the invalidation of such grossly excessive awards.

In addition, as the petition explains (at 8-11), the decision below conflicts with other decisions that have addressed the question whether, and to what extent, punitive damages awards in arbitration are subject to judicial review for excessiveness. *See, e.g.*, *Sanders v. Gardner*, 7 F. Supp. 2d 151, 176-79 (E.D.N.Y. 1998) (court should afford meaningful and adequate review of arbitration award to determine whether the ratio is excessive in light of this Court's precedents); *Sawtelle v. Waddell & Reed, Inc.*, 304 A.D.2d 103, 109-11, 117-18 (N.Y. App. Div. 2003) (arbitration award must be reviewed for excessiveness under this Court's due process precedents), *appeal after remand*, 21 A.D.3d 820 (N.Y. App. Div. 2005), *leave to appeal dismissed*, 843 N.E.2d 1158 (N.Y. 2005).

3. Review is also warranted in this case because it presents an issue of recurring importance. Standard arbitration agreements authorize awards of punitive damages. In particular, standard arbitra-

tion agreements contemplate arbitration of "all disputes," and this Court has interpreted such agreements to authorize an arbitrator to award punitive damages. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 61 & n.7 (1995). Accordingly, under the decision below, any party to a standard arbitration agreement is subject to unlimited punitive damages awards.

Respondents assert (Br. in Opp. 21) that the issue is unimportant because parties can contract around an arbitrator's authority to impose excessive punishment. But that possibility has never served as an obstacle to review of important and recurring issues presented by standard arbitration agreements. *See, e.g., Arthur Anderson LLP v. Carlisle*, 129 S. Ct. 1896, 1899 (2009); *Vaden v. Discover Bank*, 129 S. Ct. 1262 (2009); *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396 (2008). Indeed, this Court recently granted a petition to review a question concerning an arbitrator's authority under a standard agreement to entertain a class action, notwithstanding the respondents' argument that parties could contractually exclude the arbitrator's assertion of such authority. Respondents' Br. in Opposition to Certiorari at 21, *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.* (No. 08-1198); 129 S. Ct. 2793 (2009) (granting petition).

The Court's refusal to deny review of issues of recurring importance based on the possibility of contracting around the issue is understandable. Parties should not have to contract around conduct that exceeds an arbitrator's authority in the first place. And the possibility of contracting around an arbitrator's unjustified assertion of authority is wholly in-

adequate as a remedy for persons who remain bound by existing agreements.

4. Respondents argue against certiorari on the ground that the court of appeals' decision is correct on the merits. Br. in Opp. 11-12, 22-26. Respondents' arguments on the merits, however, may be considered by the Court after granting review and afford no basis for denying certiorari, particularly in light of the conflict among the lower courts and the recurring importance of the question presented by the petition.

Respondents, in any event, err in their merits arguments. As discussed, the arbitrators' $20 million punitive damages award in this case is plainly excessive under this Court's precedents. Respondents make no claim to the contrary. Instead, they argue that the Ninth Circuit was justified in failing to provide any meaningful review of that award. Respondents are incorrect.

a. Respondents first contend that this Court's decision in *Hall Street Associates* "flatly foreclose[s]" review of this case, because it provides that Section 10(a) of the Federal Arbitration Act (FAA), 9 U.S.C. § 10(a), lays out the exclusive grounds for vacatur of an arbitration award. Br. in Opp. 11-12. That argument is plainly incorrect.

"[W]here Congress intends to preclude judicial review of constitutional claims its intent to do so must be clear." *Demore v. Kim*, 538 U.S. 510, 517 (2003) (quoting *Webster v. Doe*, 486 U.S. 592, 603 (1988)). Far from expressly precluding review of a claim that an arbitrator's award of punitive damages is constitutionally excessive, the FAA, in fact, au-

thorizes such review. The FAA explicitly calls for vacatur of an award "where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." 9 U.S.C. § 10(a)(4). When arbitrators impose punitive damages awards that manifestly disregard the limitations imposed by due process, they have "exceeded their powers." Accordingly, review for constitutional excessiveness is entirely consistent with the FAA.

b. Respondents also contend that due process does not apply to arbitration awards. Br. in Opp. 16-17. But that argument fails to distinguish between procedural and substantive due process. The cases on which Respondents rely do not address whether *substantive* due process limitations on the size of a punitive damages award apply, which is what is at issue here. Instead, those cases reason that the parties waive the strictures of procedural due process by agreeing to the more informal procedures of arbitration. *See, e.g., Todd Shipyards*, 943 F.2d at 1063-64; *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 940 (10th Cir. 2001).

c. Respondents also argue that an award imposed by an arbitrator and confirmed by a court fails to constitute state action. Br. in Opp. 22-26. This Court, however, has repeatedly recognized that punitive damages serve the public functions of retribution and deterrence—the same "interests advanced by the criminal law." *Exxon Shipping Co.*, 128 S. Ct. at 2628; *see also Philip Morris USA v. Williams*, 549 U.S. 346, 358-59 (2007) (Stevens, J., dissenting) ("There is little difference between the justification for a criminal sanction, such as a fine or a term of

imprisonment, and an award of punitive damages."); *Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 432 (2001) (punitive damages "operate as 'private fines' intended to punish the defendant and to deter future wrongdoing" and are "an expression of . . . moral condemnation"). Accordingly, in awarding punitive damages, arbitrators necessarily perform a public function.

Not only does an arbitrator necessarily perform a public function when awarding punitive damages, but state action enables the performance of that public function from beginning to end. The federal statute governing arbitration is supplemented by state statutes to the extent not inconsistent with the federal regime, and together they empower the courts to strictly enforce agreements to arbitrate on motions to compel; determine, where necessary, the appointment and disqualification of the arbitrators and the content of their mandatory disclosures; enforce their statutorily granted subpoena powers; authorize discovery, including the taking of depositions under oath; and grant the arbitrators the power to administer oaths. *See generally* 9 U.S.C. §§ 1-16; Cal. Code Civ. Proc. §§ 1280-1292.2. Most importantly, the resulting award would be a hollow formality without judicial review and confirmation of the award, the resulting conversion of the confirmed award into a judgment of the court, and the court's enforcement of that judgment just as if it were a judgment resulting from a civil action. Accordingly, an arbitrator's imposition of punitive damages is subject to the Constitution's limits on excessiveness. *See Brentwood Academy v. Tenn. Secondary Sch. Athletic Ass'n*, 531

U.S. 288, 296 (2001); *Edmonson v. Leesville Concrete Co.*, 500 U.S. 614, 622 (1991).

d. The consequence of adopting the court of appeals' contrary conclusion fortifies the need for review. As noted above, under the court of appeals' approach, any arbitration panel has unconstrained authority to mete out as much punishment as it desires so long as it purports to apply due process limitations, and a court has no choice but to affirm the resulting punitive damages award. Thus, the decision below affirmed $20 million in punitive damages based upon a compensatory damages award of only $1 million even though the damages were purely economic and Respondents failed to offer any colorable justification for such a massive punitive damages award. Indeed, it is undisputed that under the decision below a punitive damages award of $40 million, $100 million, or, indeed, any amount would have had to be confirmed. Thus, parties engaged in arbitration will have no protection against grossly excessive punitive damages awards throughout the Ninth Circuit. This Court should grant review to decide whether its decisions countenance that outcome.

CONCLUSION

For the foregoing reasons, and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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